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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 823 63.

EUGENE C. JAMES,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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INDEX

	PAGE
Opinion Below	1
Jurisdiction	2
Question Presented	2
Statement of the Case	2
Statutes concerned	12, 13
Reasons for granting the writ	14
Conclusion	28

List of Authorities

Commissioner of Internal Rev. v. Wilcox, 327 U.S. 404	14
J. J. Dix Inc. v. Commissioner of Internal Revenue, 223 Fed. 2nd 436	23
Kurrie v. Helvering, 126 Fed. 2nd 733	16
McKnight v. Commissioner of Internal Revenue, 127 Fed. 2nd 572	17
Rutkin v. United States, 343 U.S. 130	18
United States v. Green, unpublished	26
United States v. Peele, 159 Fed. Supp. 45	24

Statutes

26 U.S.C. 1952 ed., Sec. 22(a)	12
26 U.S.C. 1952 ed., Sec. 145(a)	13
26 U.S.C. 1952 ed., Supp. IV, Sec. 7201	13

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To The Honorable, The Chief Justice and Associate Justices of The Supreme Court of The United States:

Your petitioner, Eugene C. James, respectfully prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Seventh Circuit in the above case.

JUDGMENT AND OPINION OF THE COURTS BELOW.

The judgment of the United States District Court for the Northern District of Illinois, Eastern Division, was entered on May 11, 1959 and is not reported.

The opinion of the United States Court of Appeals for the Seventh Circuit, affirming said judgment, was filed December 29, 1959 and is included in the Appendix hereto and in the certified copy of the Record.

JURISDICTION.

The opinion of the United States Court of Appeals was filed December 29, 1959. A Petition for Rehearing was denied February 29, 1960. This petition is filed within 30 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1), 62 Stat. 928.

QUESTION PRESENTED.

Was it not reversible error for the Court of Appeals to hold, as did the Trial Court, that the receipt of embezzled funds, where the embezzlement thereof is actual, the fact of such embezzlement having been specially found, and where the embezzlement was made the subject of criminal prosecution, constitutes the receipt of taxable income in the hands of the embezzler?

STATEMENT OF THE CASE.

This prosecution was commenced on December 13, 1957, by the return of an Indictment in four Counts under Section 145(b) of the Internal Revenue Code of 1939 (26 U.S.C. 145 (b)) and Section 7201 of the Internal Revenue Code of 1954 (26 U.S.C. 7201). The first Count of the Indictment charged the petitioner with wilfully attempting to defeat and evade a large part of the income tax due and owing by him and his wife to the United States for the year 1951 by filing a joint return for that year showing $2,353.44 due, whereas it is alleged that the petitioner knew that there was $70,037.14 owing for his tax liability for that year. The second Count charged the same offense for the year 1952, the return showing $5,997.38 due, whereas it was alleged that the petitioner knew there was due $166,195.67. The third Count related to the year 1953, for which the return showed a tax liability of $3,107.88, whereas it was alleged that the petitioner knew the amount due was $325,323.04. The fourth Count

concerned the year 1954 for which the tax liability as reported was $2,962.88, whereas the Indictment alleged the petitioner knew that the amount due was $15,847.90.

The cause was tried to the court upon waiver of trial by jury, consented to by the government and approved by the court. At the close of the evidence for the prosecution the petitioner orally moved for a judgment of acquittal, which motion was denied.

At the close of all of the evidence, the petitioner again moved orally for a judgment of acquittal, which motion was again denied. The court then found the petitioner guilty on each Count.

The court, acting under Rule 23(c) of the Federal Rules of Criminal Procedure, entered most detailed Findings of Fact, specially finding all material facts as disclosed by the evidence and additionally finding ultimate facts and conclusions of law (Petitioner's Appendix to Brief p. 7a).

Because of the detailed and fulsome Special Findings of Fact entered by the Trial Judge, which appear in their entirety in the Appendix to the petitioner's brief filed in the Court of Appeals at pages 7a to 18a with which special findings the Government is in agreement, it is believed unnecessary in this Statement of Facts for this Petitioner to do other than here again, for the convenience of this Court, repeat such special findings as the same were made and entered by the Court, as the tryer of the facts.

"Petitioner filed timely joint income tax returns for himself and his wife of the years 1951, 1952, 1953 and 1954 with the District Director of Internal Revenue at Chicago, Illinois.

"The income reported by petitioner on his returns consisted of salary received from the Laundry Workers Union, Local No. 46, located in Chicago, Illinois; salary from the Laundry Workers International Union, whose headquarters were in Indianapolis, Indiana; salary from Local No. 985 of the International Brotherhood of Teamsters, located in Detroit, Michigan; certain payments received as a Welfare Deputy for the aforementioned Local No. 46; certain expense monies received from aforementioned Local No. 46. He also reported net losses from the operation of a racing stable.

"From January 1, 1950 to August 7, 1952, petitioner was seventh Vice President and Acting General Secretary and Treasurer of the Laundry Workers International Union. From August 7, 1952 to December 31, 1954 defendant was General Secretary and Treasurer of the Laundry Workers International Union. In addition, he was Deputy Trustee in charge of Local No. 46 of the Laundry Workers Union from May 13, 1949 until October, 1954, during which period the Local was under a trusteeship. Upon termination of the trusteeship in October, 1954, he became Secretary and Treasurer of the Local.

"Throughout the years 1951 to 1954 inclusive there was in existence a welfare trust known as the Social Security Department of the Laundry Workers International Union. The trust had been created pursuant to a mandate of the 1949 Convention of the Laundry Workers International Union. The Social Security Department was an entity separate and distinct from the Laundry Workers International Union. The purpose of the trust known as the Social Security Department was to provide welfare benefits for union members. The Social Security Department was governed by six trustees, three of whom were selected by Management and three by Labor. At no time was the

defendant a trustee or other officer of the Social Security Department.

"Petitioner was appointed Welfare Deputy for Laundry Workers Local No. 46 of Chicago under a written agreement with the Social Security Department executed in October 9, 1950. This agreement provided, among other things, that petitioner was to receive 5 per cent of all premiums payable to the Security Mutual Life Insurance Company under the latter's contract covering members of Local No. 46, and that expenses incurred by defendant in investigating claims were to be paid by him out of this sum. The agreement between petitioner and the Social Security Department contained the following clause:

> "* * * Should any surplus remain after payment of said items then it may be retained [by petitioner], provided, however, that such surplus shall be reported as income [by petitioner] in accordance with law. * * *"

In his returns for the years in question, petitioner reported as gross income sums allegedly representing the difference between the amounts received and the amounts expended under the agreement.

"The Social Security Department received payments from various employers throughout the country on behalf of union employees, which payments were deposited by the bookkeeper for the Social Security Department in the Indiana National Bank of Indianapolis, Indiana. The receipt of these funds was regularly recorded by the bookkeeper of the Social Security Department.

"From April, 1950 to and including October 1, 1953, the Security Mutual Life Insurance Company of Binghamton, New York, by contract with the Social Security Department of the Laundry Workers International Union,

had in effect health and accident insurance policies covering the members of the various laundry workers' locals throughout the country. For the period March 1951 to October 1, 1953, premiums on the health and accident policies were paid by the Social Security Department to one Louis B. Saperstein of Newark, New Jersey, an insurance broker and agent for the Security Mutual Life Insurance Company.

"Louis B. Saperstein was the Managing Officer of two insurance brokerage firms known as the Harlew Agency of Illinois, Inc. and the Harlew Agency of California, Inc. All checks for payment of premiums to the Security Mutual Life Insurance Company by the Social Security Department were made payable to Louis B. Saperstein and were deposited by him, or persons employed by him, in bank accounts of either Harlew Agency of Illinois, Inc. or Harlew Agency of California, Inc.

"The funds received by Louis Saperstein from the Social Security Department during the years 1951 to 1953 inclusive were wholly disbursed by him for the following purposes:

(a) Payments to the Security Mutual Life Insurance Company of Binghamton, New York, as premiums on the policies in existence between that company and the Social Security Department for the Laundry Workers International Union;

(b) Payment of claims made by laundry worker employees who, under the terms of the policies, were ineligible to receive benefits from the Security Mutual Life Insurance Company;

(c) By checks drawn to the Order of the Laundry Workers International Union and Mailed to the defendant at his residence in Wheaton, Illinois, or at his office in the headquarters of Local No. 46 of the Laundry Workers International Union at 1640 West Van Buren Street, Chicago, Illinois.

"On September 14, 1951, petitioner opened a bank account at the Merchants National Bank, Chicago, Illinois, in the name of the Laundry Workers International Union. This bank account was opened without the authorization of the Laundry Workers International Union or the Social Security Department. The signature card for this bank account required only the signature of petitioner to effect withdrawals from the account.

"Petitioner deposited in the above-mentioned Merchants National Bank account all checks received by him from Saperstein which were payable to the Laundry Workers International Union, and which were drawn on accounts of Harlew Agency of Illinois, Inc. and Harlew Agency of California, Inc.

"The funds so received by petitioner and deposited by him in the Merchants National Bank during the years 1951, 1952, 1953 and 1954 amounted to $80,451.35; $175,265.81; $368,367.81, and $29,561.69 respectively.

"*The funds referred to in (the preceding two paragraphs) were under the laws and statutes of the State of New Jersey embezzled by the petitioner, and that under the laws and statutes of such State, the petitioner, James, is guilty of the crime of embezzlement of such funds as a principal, along with Saperstein.* (Emphasis supplied.)

"That Saperstein and the petitioner were jointly indicted for the crime of conspiracy to embezzle and for

the crime of embezzlement of the funds in question by the Grand Jurors of Essex County, New Jersey, and that such indictment is now pending in the courts of that state; and the petitioner has been ordered extradited for trial in New Jersey by order of the Circuit Court of Du Page County, Illinois, which order was affirmed by the Supreme Court of Illinois on March 20, 1959; that there is now pending before the Supreme Court of Illinois a petition for rehearing of the aforesaid order of affirmance.

"By letters dated July 17, 1951 and July 27, 1951, petitioner stated to the Security Mutual Life Insurance Company that members of the Laundry Workers International Union were performing services and incurring expenses in connection with the promotion of the welfare plans, and that in his opinion such functions and expenses were properly the burden of the insurance company. Accordingly, he requested that the insurance company consider reimbursing the union for these expenditures. By letter dated September 10, 1951, addressed to defendant, the insurance company agreed to pay the union $2,500.00 a month as reimbursement for such expenses. The agreement was made retroactive to January, 1951. Pursuant to this agreement, one check for $20,000.00, covering the retroactive period, was made payable to the Laundry Workers International Union; one check for $2,500.00 was made payable to E. C. James; the remaining monthly checks in the amount of $2,500.00 each were made payable to E. C. James, Acting Secretary-Treasurer of the Laundry Workers International Union. All of the checks were mailed to petitioner, endorsed by rubber stamp, and deposited by him in the above-mentioned account at the Merchants National Bank. For the years 1951, 1952 and 1953 the sums so received and de-

posited by the petitioner totaled $30,000.00, $32,500.00 and $22,500.00 respectively. The representations made by the petitioner to the Security Mutual Life Insurance Company in the aforementioned letters, as a result of which the above sums of $2,500.00 a month were paid by the insurance company, were made without authorization of any other officer of the Laundry Workers International Union or any trustee of the Social Security Department.

"*That the acts of the petitioner referred to in (the preceding paragraph) constituted the crime of embezzlement of the $85,000.00 therein referred to under the laws and Statutes of the State of Illinois.* (Emphasis supplied.)

"On numerous occasions during the years 1951 to 1954 inclusive, petitioner visited the Merchants National Bank of Chicago, Illinois, and drew checks on the account maintained by him at this bank in the name of the Laundry Workers Interational Union. These checks were drawn to the order of E. C. James and were immediately cashed by him at the bank. During the years in question, petitioner received from the above sources (*i.e.*, the Harlew Agencies, Inc. and the Security Mutual Insurance Company) and deposited in the Merchants National Bank the following sums:

1951	$110,451.45
1952	207,765.81
1953	390,867.81
1954	29,561.69
Total	$738,646.66.

By May 6, 1954, petitioner had withdrawn all funds which he had deposited in this account.

"None of the funds in question were paid over by the petitioner to the Laundry Workers International Union or the Social Security Department, and no part of the funds was expended by the petitioner for the benefit of the aforementioned union entities.

"During the years involved petitioner maintained safe deposit boxes at the Gary-Wheaton Bank in Wheaton, Illinois, the town in which he resided, to which safe deposit boxes he made frequent entries. During the year 1951 he made nineteen visits to the boxes; during the year 1952 he made twenty-two visits to the boxes; during the year 1953 he made nineteen visits to the boxes; during the year 1954 he made ten visits to the boxes.

"Throughout the period in question, petitioner also maintained three checking accounts and one savings account at the Gary-Wheaton Bank at Wheaton, Illinois. In addition, he maintained two checking accounts at the Central National Bank in Chicago, Illinois. Petitioner made cash deposits to his accounts at the Gary-Wheaton Bank in each of the years 1951, 1952, 1953 and 1954 totaling $27,990.00, $51,860.00, $15,200.00, and $14,310.00 respectively.

"In addition to the currency deposits during this time, which exceeded $109,000.00, defendant purchased a horse from Leopha Wilson in November, 1953, for $10,000.00 in currency. This currency was not withdrawn from any of defendant's bank accounts.

"On November 17, 1953 petitioner purchased a cashier's check at the Gary-Wheaton Bank in the amount of $2,500.00. There was no withdrawal of a like amount from any of his bank accounts on this date. However, on this same date he made an entry into his safe deposit

box at the Gary-Wheaton Bank. As testified to by Matthew J. Dooley, there was mailed to petitioner on December 28, 1953, $27,000.00 worth of stock in the Founders Syndicate of America, Inc., the certificates of which were made out in dummy names and endorsed in blank. This stock resulted from a purchase by Dooley on behalf of a group, including petitioner, which group, in the presence of Dooley, had agreed to produce the funds to buy the stock.

"An analysis of petitioner's various bank accounts does not show the withdrawal of $27,000.00 or the withdrawal of any series of checks which would account for the $27,000.00. Petitioner's contribution for the purchase of the stock was by cash not withdrawn from his bank accounts.

"None of the funds withdrawn by petitioner from his several accounts at the Gary-Wheaton Bank and the Central National Bank of Chicago during the years 1951 through 1954 were expended on behalf of the Laundry Workers International Union or the Social Security Department, but instead were expended in part for his personal use and benefit.

"The funds received by the petitioner during the years 1951, 1952, 1953 and 1954, which he deposited in the Merchants National Bank of Chicago, Illinois, and subsequently withdrew therefrom, were within his complete dominion and control, and large portions thereof were actually expended by him for his personal benefit. By the receipt of these funds he derived readily realizable economic value in the year of receipt.

"Petitioner's tax returns for the years in question were prepared on the cash receipts basis by an accountant, Daniel D. Contarsy, from information furnished by

the petitioner. Contarsy had no knowledge of the receipt by the petitioner of funds from the Harlew Agencies, Inc. or the Security Mutual Life Insurance Company, and none of such funds were reported by petitioner in his returns for the years 1951 to 1954 inclusive."

Thus, under the facts in this case, the same were recited by the detailed special findings of the trial court, the entirety of the monies obtained by the petitioner which were not included in his returns for the taxable years in question, were funds of which the petitioner obtained by means which caused him to be "guilty of the crime of embezzlement of such funds as a principal" (Petitioner's Appendix to Brief p. 11a).

STATUTES CONCERNED.

Internal Revenue Code of 1939:.

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service • • • of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. • • •

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 145. PENALTIES.

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

• • •

(26 U.S.C. 1952 ed., Sec. 145(a).)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED

(a) *General definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, • • •

• • •

SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. 1952 ed., Supp. IV, Sec. 7201.)

REASONS FOR GRANTING THE WRIT.

1. The Court of Appeals has decided an important federal question in a way in conflict with the applicable decisions of this Court.

2. The Court of Appeals has rendered a decision in conflict with decisions of other Courts of Appeal.

1.

This Supreme Court in the case of *Commissioner of Internal Revenue* v. *Laird Wilcox*, 327 U.S. 404, 416, 90 L. 752-759, in an opinion handed down on February 25, 1946, made what was the first, the last and only direct expression by the Court on the taxability of embezzled funds. In *Wilcox*, the taxpayer, a bookkeeper for a transfer and warehouse company in Reno, Nevada, had over a five year period from 1939 through 1942 diverted miscellaneous sums of money belonging to his principal, pocketing them, and thereafter losing practically all of his ill-gotten gains in various gambling houses in Reno. His improper takings during the calendar year of 1941 amounted to $12,748.60. His acts constituted criminal embezzlement under the laws of Nevada, and for this crime he was indicted and convicted in the courts of that state in 1942, and sentenced to serve from 2 to 4 years in prison, from which he was paroled in 1943. The Commissioner determined that the taxpayer was required to report the $12,748.60 which he embezzled during 1951 and in this determination was sustained by the Tax Court. After the reversal of the Tax Court by the decision of the Ninth Circuit above referenced, certiorari was granted "because of a conflict among circuits as to the taxability of *embezzled* money". (Emphasis supplied).

The Government argued (as it does here, in the case at bar) that taxability rested "upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." To this argument the Supreme Court said "We cannot agree," continuing:

> "Taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a). See *North American Oil Consolidated* v. *Burnett*, 286 U.S. 417, 424, 76 L.ed. 1197, 1200. Nor can taxable income accrue from the mere receipt of property or money which one is obligated to return or repay to the rightful owner, as in the case of a loan or credit."
>
> * * *
>
> "We fail to perceive any reason for applying different principles to a situation where one embezzles or steals money from another. Moral turpitude is not a touchstone of taxability. The question, rather, is whether a taxpayer received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of Section 22(a).
>
> "It is obvious that the tapayer in this instance in embezzling the $12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all time under an unqualified duty and obligation to repay the money to his employer. Under Nevada law, the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was

appropriated or to have it summarily restored by a magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title, and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement.

"This conclusion is unaltered by the fact that the taxpayer subsequently dissipated all of the embezzled funds in gambling houses. The loss or dissipation of money cannot create taxable income here any more than the insolvency or bankruptcy of an ordinary borrower causes the loans to be treated as taxable income to the borrower."

* * *

"Sanctioning a tax under the circumstances before us would serve only to give the United States an unjustified preference as to part of the money which rightfully and completely belongs to the taxpayer's employer.

"*The Tax Court's determination that the embezzled money constituted taxable income to the embezzler, a result in accord with its prior decisions on the issue, involved a clear-cut mistake of law.* The court below was, therefore, justified in reversing that judgment." (Emphasis supplied.)

Prior to this holding among the Circuits themselves, no unanimity existed. The Eighth Circuit by its decision in *Kurrie* v. *Helvering*, 126 F. 2d 733 (Mar. 14, 1942), in affirming an order of the Board of Tax Appeals taxing an embezzler from an Iowa bank upon the proceeds of his embezzlement and the profits earned by the use of such funds, had held that although the embezzler was a trustee *ex malificio*, "embezzled funds and profits earned by the embezzler through the use of such funds constitute taxable income." In the Fifth Circuit, however, less than two

months after the *Kurrle* case, a diametrically contrary view as adopted in the case of *McKnight* v. *Commissioner of Internal Revenue*, 127 F. 2d 572 (Apr. 29, 1942). It was in order to resolve this conflict, that this Supreme Court granted the Government's application for certiorari in *Wilcox* v. *Commissioner of Internal Revenue*, 148 F. 2d 933, Ninth Cir., (Mar. 30, 1954), wherein the *McKnight* case's reasoning had been sanctioned.

Subsequent to *Wilcox*, the Internal Revenue Service itself in General Counsel Memo. 24945, Cum. Bull. 1946-2, 27 reversed its prior position regarding the taxability of embezzled funds such as in the *Wilcox* case, and recognized them not to be taxable.

From the position enunciated in this General Counsel Memo. the Internal Revenue Service has never retreated and this Memo. is in full force and effect today.

It is to be noted that *Wilcox* did not hold, as has heretofore in some cases been incorrectly argued on behalf of various taxpayers, that the illegality of the means by which the funds were obtained thereby rendered them nontaxable. This is clearly not, now and has never been the law. Unlawful gains, where the same are realize under a claim of right and without a definite and unconditional obligation to repay, are taxable equally with lawful gains, and such state of the law was not disturbed by *Wilcox* The sole question authoritatively and finally determined by *Wilcox* was the express recognition of the non-taxability of moneys obtained wrongfully—without claim of right—when the obtention of such moneys created a definite and unconditional obligation to return the same.

After the decision in the *Wilcox* case and the following General Counsel's Memo referenced above, no question as

to the non-taxability of funds so obtained seems to have been raised in reported decisions until 1952.

However, on March 24, 1952, this Supreme Court, handed down the decision in the case of *Rutkin* v. *United States of America*, 343 U.S. 130, 96 L.ed. 833, 72 Sup. Ct. 571, holding money obtained by extortion to be taxable. The petition in the case at bar wishes to here and now state that with the *Rutkin* holding, he has no quarrel. Indeed, it is not felt that *Rutkin* in any way altered the law as it had been prior to *Wilcox* nor did it in any way change or obliterate in any part whatsoever the rule of *Wilcox*. Unfortunately, however, it must be acknowledged that *Rutkin* has formed the basis for much dicta, which is the effect that the rule of Wilcox was in some way diluted or modified by *Rutkin*. In fact, such was the view of the minority of the Court. However, the petitioner believes that the actual effect of *Rutkin* was merely to prevent an extension of *Wilcox's* doctrine into areas of taxability in which the law was already clear in affirming that gains were taxable. (See *Humphries* v. *Commissioner*, 125 F.2d 340, wherein extortion or kidnap proceeds had previously to *Rutkin* been held taxable and in which certiorari was denied in 317 U.S. 637, 87 L.ed. 513, 63 Sup. Ct. 28). *Rutkin* did not alter *Wilcox's* holding or destroy its rationale.

It is important here to closely analyze the facts in *Rutkin*. Rutkin was indicted for wilful failure to include in his tax return for 1943, $250,000.00 which he had received during that year from one Joseph Reinfeld. The circumstances of the receipt of the funds were complex. Reinfeld had been engaged in 1929 with the defendant in a bootlegging operation known as the "High seas venture". The defendant was taken into the enterprise because of

fear that he or his associate would otherwise create trouble, and was given a 6% interest in the venture for which he appears to have been paid. In 1933 (upon repeal of prohibition) Browne Vintners Co., a New York corporation, was organized to engage in the liquor business by Reinfeld and others. Rutkin was not included in this new venture, but thereafter asserted a claim of a 6% interest in this enterprise as well. In 1940 all of the stock of Brown Vintners was sold for $7,500,000.00 to a purchaser who also assumed $8,000,000.00 of the company's debts, but no money was then paid to Rutkin who was not a stockholder of record, nor a beneficial owner of any of the company's stock but who was nevertheless actively claiming and asserting an interest therein. Thereafter repeated demands were asserted by Rutkin upon Reinfeld for sums ranging up to $500,000.00, Rutkin "threatening use of a gun" and to "kill Reinfeld and Reinfeld's family unless his demands were met." Finally, in 1943, Reinfeld paid Rutkin the $250,000.00 in question, and *Rutkin thereupon signed and Reinfeld received a general release purporting to release Reinfeld, Browne Vintners Company and others from all claims of Rutkin.*

It is to be noted that this Supreme Court (page 134 of the Official Reports) pointed out in describing the demands of Rutkin:

> "Throughout this melodrama petitioner (Rutkin) asserted he was entitled to the payments he demanded from Reinfeld because of petitioner's former interest in Browne Vintners Company."

Thus, clearly, Rutkin received the money under a definite "claim of right". It is of no consequence that such claim was in fact invalid, and was not given credence by Reinfeld. The term "claim of right" means what the expression implies—a claim of right—not an actual right. Such

a claim of right was the basis upon which Rutkin demanded the money, then received the same, and for which he ultimately executed his written release. In the opinion below (*Rutkin* v. *United States*, 189 F.2d 431) the court applied the "claim of right" doctrine by holding that the extortioner received the money with a "semblance of a bona fide claim of right", since Reinfeld never denied the presence of a claim of right by him for some money, and the extortioner, when asking his victim for money, called it "my money", and gave a general release at the time he was given the money. As pointed out below "Reinfeld has unmistakably considered the $250,000 to be Rutkin's property. He left Rutkin in undisputed possession of it for the last eight years."

The Supreme Court declared such money, so obtained to be taxable. In its opinion, after recognizing that Rutkin's "control over the cash so received was such that, in the absence of Reinfeld's *unlikely repudiation* of the transaction and demand for the moneys' return, petitioner could enjoy its use as fully as though his title to it were unassailable", (emphasis supplied) and pointing out that unlawfully obtained income is taxable similarly to lawful gains, the Court said:

> "There is little doubt now that where unlawful gains are secured by the fraud of the taxpayer they are taxable. In the instant case it is not questioned that the $250,000 would have been taxable to petitioner if he had obtained it by fraudulently inducing Reinfeld to believe petitioner's false claims to be true. That being so, it would be an extraordinary result to hold here that petitioner is to be tax free because his fraud was so transparent that it did not mislead his victim and his victim paid him the money because of fear instead of fraud.

"We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 US 404, 90 L.ed. 752, 66 S.Ct. 546, 166 ALR 884. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22(a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22(a)."

Clearly, it would seem, *Rutkin* does not overrule *Wilcox*. Indeed, quite on the contrary, it reaffirms *Wilcox*.

Very simply, *Rutkin* was an extortion—not an embezzlement case. Rutkin got the money claiming that he was entitled to it (although such claim was not valid, and the real reason for payment was fear of physical violence induced in the payor). Neither petitioner nor Wilcox claimed any right to the funds thus received. Rutkin got good legal title to the money, and, as pointed out by this Court, it was, as a practical matter, extremely unlikely that Reinfeld, who paid because of fear, would thereafter repudiate his deal and seek the recovery of the funds. Neither Wilcox nor petitioner, however, at any time obtained legal title to the money of which they took possession. The rightful owner of the same could (and in fact, in the case of petitioner actually did) pursue the same. In the petitioner's case, as in *McKnight* v. *Commissioner of Internal Revenue*, *supra*, "the takings were large, and under a system of bookkeeping that made discovery and the demand for recovery eventually certain." (See 127 F.2d at page 574.) Rutkin, on the contrary, obtained clear legal title to the funds, could and did use them as his own, and never at any time had occasion to fear or anticipate that any person whomsoever would challenge his title to the same. The money in

short was as a practical matter his. The money taken by petitioner and by Wilcox was not theirs.

It is to be observed that the two mandatory indicia of taxability established in *Wilcox, i.e.* (1) claim of right to the gain and (2) absence of a definite, unconditional obligation to repay still applied after *Rutkin*. In the *Rutkin* case there was both a claim of right and, in view of the circumstances of the extortion, there was a practical absence of a definite unconditional obligation to repay.

Although in no reported case whatsoever decided by any court, has *Wilcox* been overruled and although all cases recognize in varying degrees the rule of *Wilcox*, parts of the language of the decision in *Rutkin* has, from time to time, been relied upon in the opinions of lower courts as the basis for distinctions drawn from the *Wilcox* case. These cases have been set out in chronological order and the distinguishing features thereof pointed up in the petitioner's brief filed in the Court of Appeals and made a part of this Record from page 26 through page 40.

Thus, we find that in the decision of the Court of Appeals for the Seventh Circuit to which this petition is directed, the Court is in error, in holding as it does. "Thus *Rutkin* was an interpretation of Section 22(a) in keeping with precedent, and the economic use and benefit test there announced—unlike the claim of right test of *Wilcox*—provided a rule of law susceptible of ready and uniform application to all unlawful gains, however acquired."

The salient facts present in *Wilcox* and in the petitioner's case are in close analogy and are distinguishable from every case in which the doctrine of taxability enunciated in the *Wilcox* case was rejected by a Court of Appeals relying on the *Rutkin* theory.

2

The decision of the Court of Appeals for the Seventh Circuit to which this petition for certiorari is directed stands in direct conflict with the decision of the Court of Appeals for the Second Circuit in *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue*, 223 F. 2d 436 (2d CA), June 2, 1955, cert. den. 350 U.S. 894, in which that Court expressly reaffirmed *Wilcox* in considering the tax liability of the president of a corporation for corporate funds in the amount of $56,736.82 which he had misappropriated. The language of the Court on the question was:

"The Tax Court held that Jacob Dix realized taxable income of $56,736.82, *i.e.*, the amount of corporate funds he misappropriated. We think this was erro Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think *Commissioner of Internal Revenue* v. *Wilcox*, 327 U.S. 404, 66 S.Ct. 546, 90 L.Ed. 833, governs, and that *Rutkin* v. *United States*, 343 U.S. 130, 72 S.Ct. 571, 96 L.Ed. 833, does not apply. We do not believe that *Rutkin* completely obliterated *Wilcox*. 'Since the court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler and in the *Rutkin* case has unequivocally held that extorted funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case.' *Marienfeld* v. *United States*, 8 Cir., 214 F.2d 632, 637. In the instant case, the facts are close to those of *Wilcox* and lack the distinguishing features found in *United States* v.

Bruswitz, 2 Cir., 219 F.2d 59, and cases there cited. See also the dissent of Judge Kalodne in *Kann* v. *Commissioner*, 3 Cir., 210 F.2d 247, 253."

Obviously, in the petitioner's case he is even closer to *Wilcox* than was Dix. In *James* the embezzler was not in control of the Union or the Insurance Company, whereas Dix was the president of the victim corporation. In the petitioner's case we have real, actual pursuit of the moneys embezzled, an utter absence of any claim of right, and, moreover, an existing prosecution for embezzlement and the fact of the embezzlement of the funds so found by the District Court.

The Court's attention is also invited to two recent District Court decisions wherein the *Rutkin* and *Wilcox* cases were closely examined. In *United States* v. *Peelle*, 159 F. Supp. 45, Eastern District of N.Y., February 4, 1958, so-called "secret" corporation bank accounts were used by Henry E. Peelle, an officer of the corporation, without knowledge or consent of other officers of the corporation, and moneys extracted therefrom for his own personal use. It seems difficult to perceive how a set of facts more closely analogous to the petitioner's case could be envisoned. The device utilized to effect the embezzlement in both *Peele* and petitioner's case was virtually identical. In holding *Wilcox* controlling under such a set of facts, the Court in its fulsome and well reasoned opinion said:

"In support of the defendants' contention that this embezzled money is not taxable to defendant Peelle, *Commissioner of Internal Revenue* v. *Wilcox*, 1946, 327 U.S. 404, 66 S.Ct. 546, 90 L.5d. 752, is cited. The Tax Court has ruled that embezzled money constituted taxable income to the embezzler. The Supreme Court ruled that this was a clear-cut mistake of law.

That decision pointed out (327 U.S. at page 408. 66 S.Ct. at page 549):

> '• • • a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a) (26 U.S.C.A. Section 22(a)). • • • Nor can taxable income accrue from the mere receipt of property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent. And if the unconditional indebtedness is cancelled or retired taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of Section 22(a).'
>
> • • •

"The Circuit Court in Appeals for the Second Circuit, in *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue*, 223 F.2d 436, held that funds embezzled by a president of a corporation were not taxable to the president, the embezzler. The facts in that case can be summarized briefly as follows: J. J. Dix was the president who dominated a family corporation. By deceiving his son who was the only other responsible corporate executive he withdrew money from corporate accounts without the consent, coerced or otherwise, of the company and diverted the funds to

his own use. The court held that the fact that he was the president did not amount to corporate consent and that his acts amounted to a simple case of embezzlement. The corporation was taxed for this embezzled money. The court ruled that Dix could not be taxed.

"This *Dix* case, *supra*, follows the *Wilcox* case, *supra*, and distinguishes *Rutkin* v. *United States*, 343 U.S. 130, 72 Ct. 571, 96 L. Ed. 833. In the *Rutkin* case the Supreme Court held that moneys obtained by extortion induced by harassing demands and threats of violence is income taxable to the extortioner.

* * *

"The amounts taken out of these so-called 'secret' bank accounts and embezzled by Henry E. Peelle and converted to his own use and later returned, therefore, are not taxable income."

Finally, we come to the recent decision of Judge Charles E. Wyzanski, Jr. in *United States* v. *Vera Green*, (decided March 31, 1959) in the United States District Court for the District of Massachusetts.

The pertinent facts of the *Green* case, as quoted from the yet unpublished decision of Judge Wyzanski, are:

"At all material times Vera Green was the clerk, secretary and director of Botwinik Brothers of Massachusetts. She owned 40 shares out of the 750 shares which had been authorized and issued. Without any authority from the board of directors and in violation of her duty as an officer, director and employee, she utilized for her personal purposes, or for the purposes of her husband or a corporation in which she was interested, corporate assets belonging to Botwinik Brothers of Massachusetts, Inc. It is quite unnecessary at this stage to recite the form in which these diversions occurred. (AUTHOR'S NOTE: These embezzlements amount to $139,000.00). Some

of them were by way of petty cash vouchers, others by way of accounts payable invoices, and others in other ways. From the facts which have been stipulated it is clear that many of these diversions were subject to prosecution and conviction under the State law of Massachusetts governing larceny and, more particularly, under the provisions which incorporate the old common law crime of embezzlement. In fact, up to now Mrs. Green has not been prosecuted in the state courts for this larceny. It does not appear whether she will hereafter be prosecuted in view of the admissions made in connection with these proceedings."

The ruling of the Court then follows:

"With respect to the joint income tax returns, I am cabined by the decision rendered by the Supreme Court of the United States in *Commissioner* v. *Wilcox*, 327 United States 404 (1946). The Supreme Court of the United States 13 years ago decided that embezzled money does not constitute taxable income to the embezzler under Section 22(a) of the Internal Revenue Code. It makes no difference whether I do or do not agree with that ruling. The Supreme Court has not impaired its authority. Indeed, in refusing to review the decision of the Second Circuit rendered in *J. J. Dix, Inc.* v. *Commissioner*, 223 Federal 2d, 436, it seems as though the Supreme Court of the United States is quite content to leave the *Wilcox* doctrine stand. Moreover, the Congress of the United States has not chosen to alter the doctrine in the *Wilcox* case. It is undeniable that the decision of the Supreme Court was reported to Congressional Committees and that despite this report and despite a recodification and general overhauling of the Internal Revenue Code within the last decade, no legislative alteration in the *Wilcox* doctrine has been made. It would be unseemly for a District Judge, in the light of these circumstances, not to follow the *Wilcox* case,

and it would be particularly undesirable for a single District Judge to create fine distinctions between the *Wilcox* case and the facts of this case, which is a criminal proceeding.

"Needless to say, if the Government feels that distinctions urged before me are of great importance, and should be presented to a bench of several judges, it is possible for the Government to proceed civilly against these defendants, and then if the Government loses in the civil action to take appropriate appeal to bring the matters before higher tribunals

"In all cases it is of importance for the Court not only to act justly but to appear to act justly, and it would appear to many people to be shocking in a criminal case for a single judge to enunciate fine-spun distinctions between that case and what has commonly been regarded as a landmark case in the Supreme Court of the United States.

"The motion is granted in toto. The defendant stands acquitted."

Thus, it is apparent that the decision of the Court of Appeals for the Seventh Circuit to which this petition is directed stands in conflict with decisions of other Circuits and can only add to the confusion now existing in the courts as to the proper application of the rule in *United States v. Wilcox, supra,* and *United States v. Rutkin, supra.*

CONCLUSION.

For the foregoing reasons this petition for writ of certiorari should be granted.

Respectfully submitted,

JOSEPH E. GREEN,
RICHARD E. GORMAN,
Attorneys for Petitioner.

APPENDIX.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 12719 SEPTEMBER TERM, 1959 SEPTEMBER SESSION, 1959.

UNITED STATES OF AMERICA,
Plaintiff-appellee,
v.
EUGENE C. JAMES,
Defendant-appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

December 29, 1959

Before SCHNACKENBERG and KNOCH, *Circuit Judges*, and PLATT, *District Judge*.

SCHNACKENBERG, *Circuit Judge*. After a trial without a jury, the district court found defendant Eugene C. James guilty of wilfully attempting to defeat and evade a large part of income tax due and owing by him and his wife for each of the years 1951 to 1954 inclusive, as alleged in a four count indictment. From judgment entered on the said findings, defendant has appealed.

The facts are not in dispute. The monies obtained by defendant amounting to over $700,000, which were not included in his returns for the taxable years, were misappropriated by him, partly from a union entity and partly from an insurance company, by means which made him guilty of the crime of embezzlement of such funds as a principal, under applicable laws of New Jersey. Defendant and one Saperstein were indicted for said embezzlement in New Jersey and an order of extradition of defendant from Illinois to New Jersey was affirmed by the

Illinois Supreme Court, *James* v. *Lynch*, 16 Ill. 2d 380 (1959), and a petition for rehearing denied May 19, 1959.

Defendant argues that the receipt of embezzled funds, where the embezzlement has been made the subject of criminal prosecution, and when the fact that the funds were obtained by the crime of embezzlement has been specifically found by the trial court, does not constitute taxable income to the embezzler. He relies on *Commissioner* v. *Wilcox*, 327 U.S. 404 (1946). However, plaintiff contends that, as applied to the facts in this case, the *Wilcox* interpretation of section 22 (a)[1] was rejected by *Rutkin* v. *U.S.*, 343 U.S. 130 (1952). In *Rutkin*, it was held that money obtained by extortion constitutes taxable income to the extortioner. The court applied this test, at 137:

> An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. *Burnet* v. *Wells*, 289 U.S. 670, 678; *Corliss* v. *Bowers*, 281 U.S. 376, 378. • • •

The court referred, at 138, to *Wilcox* in these words:

> We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U.S. 404. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22 (a). We think the power of Congress to tax these receipts as income under the Sixteenth Amendment is unquestionable. The broad language of § 22 (a) supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income. We therefore conclude that § 22 (a) reaches these receipts.

Three years later, in *Commissioner* v. *Glenshaw Glass Co.* 348 U.S. 426 (1955), the court cited *Rutkin* in support of its holding, at 429-430, that Congress, in enacting sec-

[1] 28 U.S.C.A. (1939 I.R.C.) § 22 (a).

tion 22 (a), "applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature"; and that it thereby intended "to tax all gains except those specifically exempted", and thus (433), "to bring the taxing power to bear upon all receipts constitutionally taxable • • •."

Again, whereas the *Wilcox* interpretation resorted to *state* law in determining the absence of a bona fide claim of right to the alleged gain and the existence of an obligation to repay it, *Rutkin* made no resort to state law. Instead it recognized the well settled principle that in matters of federal taxation "Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law". *Lyeth* v. *Hoey*, 305 U.S. 188, 194 (1938). See also, *United States* v. *Pelzer*, 312 U.S. 399 (1941); *Jerome* v. *United States*, 318 U.S. 101 (1943); *Estate of Putnam* v. *Commissioner*, 324 U.S. 393 (1945). Thus *Rutkin* was an interpretation of section 22 (a) in keeping with precedent, and the economic use and benefit test there announced—unlike the claim of right test of *Wilcox*—provided a rule of law susceptible of ready and uniform application to all unlawful gains, however acquired.

For the reasons herein set forth, the judgment of the district court is affirmed.

AFFIRMED.

UNITED STATES COURT OF APPEALS
For The Seventh Circuit

Chicago 10, Illinois

Tuesday, December 29, 1959

Before

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

Hon. Casper Platt, District Judge

United States of America, *Plaintiff-Appellee,* vs. Eugene C. James, *Defendant-Appellant.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 12719

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby Affirmed, in accordance with the opinion of this Court filed this day.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago 10, Illinois

Monday, February 8, 1960

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

No. 12719 vs.

EUGENE C. JAMES,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

On consideration of the motion of counsel for defendant-appellant for extension of time in which to file petition for rehearing, and affidavits in support of said motion, counsel for plaintiff-appellee having filed no objections thereto,

IT IS HEREBY ORDERED that the time within which defendant-appellant may file a petition for rehearing in this cause be extended for five (5) days from this date.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago 10, Illinois

Monday, February 29, 1960

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

Casper Platt, District Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

No. 12719 vs.

EUGENE C. JAMES,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

It is ordered by the Court that the petition for a rehearing of this cause be, and the same is hereby, DENIED.